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SEC Updates Accredited Investor Definition; Makes Related Changes to Qualified Institutional Buyer Definition

WRITTEN BY

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The Securities and Exchange Commission on August 26, 2020 adopted changes to the definition of accredited investor intended to modernize the exempt offering process. It also made related changes to the definition of qualified institutional buyer. This was one of two actions taken by the SEC on that date; see our blog post relating to changes to certain public company disclosure requirements at this link.

The concept of "accredited investor" is important in identifying investors able to readily participate in private offerings exempt from registration. For example, an issuer can sell to an unlimited number of accredited investors in a Rule 506(b) offering, and can do so without meeting any express information requirements. In addition, an issuer can sell only to accredited investors that it has verified as such in a Rule 506(c) offering using general solicitation. In the past, accredited investors were determined by quantitative measures, income or net worth tests for individual investors and total assets for institutional investors. These objective measures were used as a surrogate for financial sophistication, either directly or through the ability to obtain advice. In its recent action, the SEC adopted amendments to the definition of accredited investor to add qualitative measures for individuals based on professional certifications, designations or credentials and to expand the institutional investors that qualify, both by identifying more types of institutions and adding an additional test based on amount of investments. Notably, the SEC did not change any of the existing quantitative tests, which have been in place unchanged for many years.

Specifically, the amendments:

- Add a new category for individuals based on credentials designated by the SEC from time to time, which initially include holders in good standing of Series 7, Series 65 and Series 82 licenses (generally securities professionals). The SEC invites suggestions for other designations.
- Add "knowledgeable employees" of private funds for investments in that fund.
- Add certain institutions to the list of those that can qualify based on having $5 million in total assets, including codifying the SEC's prior interpretation that limited liability companies can qualify.
- Permit any entity to qualify if it has investments in excess of $5 million and was not formed for purposes of the investment.
- Add family offices with at least $5 million in assets under management and their family clients.
- Replace "spouse" for the joint annual net income test with "spousal equivalent."

The amendments also expand the definition of "qualified institutional buyer" for purposes of Rule 144A to include any institutional investors included in the accredited investor definition so long as they meet the $100 million in securities owned and invested requirement.

The amendments are welcome changes to modernize the rules even though they are unlikely to expand significantly the ability of companies to access capital. The SEC's adopting release with the full text of the changes is available at this link, with the initial order designating credentialed securities professionals as accredited investors available at this link. The amendments take effect 60 days after publication in the Federal Register.

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If you have any questions about these changes or related topics, your regular Locke Lord contact or any of the authors can discuss these matters with you.

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